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IN THE

Supreme Court of the United States

OCTOBER TERM—1944.

No. 1233

THE NATIONAL BRONX BANK OF NEW YORK,
Petitioner,

—against—

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF.

MEYER D. SIEGEL,
Attorney for Petitioner.

ALPERT PRESS, BROOKLYN, N. Y., TEL. TRIANGLE 5-1058-1059

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IN THE

Supreme Court of the United States

THE NATIONAL BRONX BANK OF NEW YORK,
Petitioner,

—against—

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

To the Honorable Chief Justice and the Honorable Associate Justices of the Supreme Court of the United States:

Your petitioner, The National Bronx Bank of New York, a national banking association, respectfully prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Second Circuit, entered February 9th, 1945, which affirmed a decision of The Tax Court of the United States, entered February 22nd, 1944 (fols. 91-93; transcript of record), sustaining deficiencies proposed by the respondent in the income tax of your petitioner for the years 1938-1939 aggregating $12,025.11.

PROCEEDINGS BELOW.

The Commissioner of Internal Revenue, on February 20th, 1942, proposed and asserted deficiencies in petitioner's income tax return for 1938 the sum of $6,237.95 and the year

1939 the sum of $9,882.02. Petitioner duly appealed from said determination to the Tax Court of the United States (Docket Number 110466). Upon a stipulation of facts, and upon parol testimony, the Tax Court handed down an opinion and decision (pp. 18-31, transcript) affirming the determination of the Commissioner.

On appeal duly taken to the United States Circuit Court of Appeals, the determination of the Tax Court was affirmed. The opinion and concurring opinion of two of the Justices of the Circuit Court are appended hereto (pp. 20-22).

JURISDICTION.

The jurisdiction of this Court is based upon Section 240 (a) of Judicial Code and upon the provisions of Revenue Act of 1926, Chapter 27, Section 1003, 44 Stat. 110.

QUESTIONS INVOLVED.

Below, by a formal written stipulation, all of the pertinent facts involved were agreed upon (fols. 118-132) and after the respondent consented to the exclusion of certain items (fol. 124) for a recomputation under Rule 50, there remained only one question of fact and law to be determined. The petitioner claimed that upon the sale of certain bonds and other securities in 1938 and 1939 which it had owned and held for several years prior thereto, that the profit or loss should be determined by the original cost price of said securities and not affected by write-downs or charge-offs entered on the books of the petitioner pursuant to orders of national bank examiners who audited the books and accounts of the petitioner during 1933, 1935 and 1936.

Petitioner contended below that because the write-downs were:

(a) Involuntary when entered in the books of the bank and made solely under the orders of the bank examiners;

(b) Were made without ascertainment of total or partial worthlessness;

(c) Resulted in no tax benefit to the petitioner;

(d) That the same were not properly deductible as losses in prior years,

that, upon the sale of the bonds, the profit or loss upon the sale can be determined only by reference to the cost price of the bonds unaffected by the arbitrary write-down figures set by the bank examiners.

The Tax Court ruled:

(a) That although the write-downs were in fact involuntary for the respective years (fol. 79), that petitioner, nonetheless, by reporting the write-downs and claiming the loss in its income tax return for the years of such write-downs, thereby concurred in the bank examiners' determination of partial worthlessness and thereby represented the bonds to be partially worthless to the extent claimed (fols. 80-81);

(b) That the fact that the petitioner enjoyed no tax benefits from such deductions in prior years, when they were claimed and allowed, is immaterial (fol. 89).

The Circuit Court of Appeals ruled:

(a) That the opinion of this Court in *Dobson* v. *Commissioner*, 320 U. S. 489, 64 S. Ct. 239, relied on by your petitioner, was a dubious precedent as to which there seems considerable confusion;

(b) That the agreed statement of facts submitted to the Tax Court presented a moot question of fact which the Trial Court resolved properly as a question of fact.

GROUNDS URGED FOR ALLOWANCE OF WRIT.

(a) The decisions of the Circuit Court of Appeals and of the Tax Court involves the interpretation of a federal law which is in conflict with the decision of this Court in the case of *Dobson* v. *Commissioner* (*supra*). Whilst the opinion and decision of the Tax Court were made and filed prior to the publication of the decision in the *Dobson* case and without the benefit of its dicta, the opinion of the Circuit Court did take cognizance of it.

(b) The main questions involved on this appeal are of utmost importance, not only to petitioner but to numerous other financial institutions similarly situated and to all taxpayers, so as to merit consideration and final decision by this Court, as follows:

(1) Involuntary write-downs of negotiable bonds to current market quotation, by order of bank examiners, without resulting tax benefit, is not evidence of total or partial worthlessness of such bonds when obligors are concededly solvent at time of such write-downs.

(2) A taxpayer is not estopped from asserting legal rights by an erroneous claim for an unallowable deduction in its returns for prior years; the rules and principles applicable to admissions in pleadings do not apply to tax returns.

(3) The fact that a taxpayer derived no tax benefit from deductions for write-downs theretofore claimed, is material and decisive in determining the tax on subsequent sale of the security.

(4) A tax claim is not "allowed" by the Commissioner if no tax benefit accrues to the taxpayer.

PRAYER.

WHEREFORE, your petitioner prays that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals of the Second Circuit, commanding the Court to certify and

to send to this Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and proceedings in the case numbered docket number 97 October Term 1944, and entitled "The National Bronx Bank of New York, Petitioner, against Commissioner of Internal Revenue, Respondent", and that said judgment of the said Circuit Court of Appeals, Second Circuit may be reviewed by this Honorable Court, and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem just.

Dated, New York, April 16th, 1945.

THE NATIONAL BRONX BANK OF NEW YORK
By: MEYER D. SIEGEL,
Attorney.

STATE OF NEW YORK
CITY OF NEW YORK } ss.:
COUNTY OF NEW YORK

MEYER D. SIEGEL, being duly sworn, deposes and says: That he is the attorney for the petitioner in the foregoing petition; that he has read said petition and has personal knowledge of the matters and things therein set forth and believes the same to be true.

Affiant further states that said petition for a writ of certiorari is prepared and filed in good faith, believing the same meritorious, and that said petition is not prepared and presented in order to be vexatious or to delay the final opinion and judgment in the case.

MEYER D. SIEGEL.

Subscribed and sworn to before me
this 16th day of April, 1945.

MATHEW BALMUTH,
Commissioner of Deeds,
New York County,
Commission Expires February 2, 1946.

IN THE

SUPREME COURT OF THE UNITED STATES.

THE NATIONAL BRONX BANK OF NEW YORK,
Petitioner,

—against—

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF IN SUPPORT OF PETITION.

STATEMENT OF THE CASE.

The petitioner is a national banking association incorporated March 13th, 1926 and is subject to the jurisdiction of the United States Comptroller of Currency (Stipulation, fol. 120). The petitioner's income tax returns for the taxable years 1938 and 1939 were filed with the Collector of the Fourteenth District of New York upon an accrual basis (Stipulation, fol. 121). The petitioner reported the sale in the years 1938 and 1939 of certain bonds which it had purchased several years prior thereto. The statistical data concerning the said securities, the date of purchase, par value, cost, prior charge-offs or write-downs, selling price, etc., are contained in Exhibit "A" of the stipulation (fols. 130-132). It was stipulated (fol. 125) that all of the bonds write-downs were on the order of national bank examiners who periodically audited the books and accounts of the bank with a view to its financial condition and solvency.

In 1933 and in 1935 and 1936 the bank examiners directed the petitioner to write-down the values of certain securities in its books, to certain arbitrary sums below cost. The uncontradicted testimony of H. G. Barber, Executive Vice-President of the bank, is to the effect that such write-downs were involuntary and were made solely in slavish obedience to the bank examiner's orders (fol. 138) and the Court below so found as a fact (fol. 79). Furthermore, that the bank had available such standard services as Moody's, Standard Statistics and Poor's with regard to the financial status of the obligors named in the bonds (fol. 138) and that from such information the petitioner had "no intention of writing down these bonds because, as stated previously, we felt that the reports we had justified us carrying those bonds at the cost to the bank" (fol. 153). The financial statements and reports concerning the obligors of the bonds is contained in petitioner's Exhibit "1" (fols. 238-543). The information therein contained was submitted to and checked by counsel for the respondent (fol. 143). The evidence was not objected to as to form but solely on the ground that it was immaterial (fol. 144).

For example (fol. 130), thirty $1,000 bonds of International Telephone & Telegraph at 4½%, purchased at a cost of upwards of $39,000, were written down to par in 1935, despite the fact that the financial statement of International Telephone & Telegraph, certified and audited by most reputable authorities, showed net assets over and above liabilities in excess of $268,000,000 (fol. 65) with a most lucrative thriving business.

Needless to say, the write-downs ordered by the bank examiners constituted only a bookkeeping entry dictated by conservative banking principles. The fact is that after the write-downs were made, they were necessarily reflected in the current financial and profit and loss statements of the petitioner and, likewise, were incorporated in the income tax returns for the respective years, not because of any tax benefits derived therefrom, but merely as a true disclosure of profits and losses according to its books, in compliance with Treasury Department regulations.

The Court below held, as a mixed question of law and fact, that the mere inclusion and deduction of the write-downs in the tax returns for the respective years constituted a representation of ascertainment of total or partial worthlessness of the said securities. Furthermore, that the Commissioner had "allowed" the deduction for the year in question. Petitioner denies (as a matter of law) that the Commissioner did allow such deduction in 1935 and relies upon the entire file produced by the Commissioner of Internal Revenue as petitioner's Exhibits "2", "3", "4" and "5" (fols. 544-594) as incontrovertible evidence to the contrary.

Thus, the basic factual evidence is not in dispute or controversy. There is complete agreement as to the factual evidence. Inferences and conclusions of facts drawn from the agreed statement of facts are in most instances questions of law or a mixed question of law and fact, reviewable by this Court. *Commissioner* v. *Heininger*, 320 U. S. 467, 64 S. Ct. 249.

JURISDICTION.

(1) Jurisdiction of this Court is based upon Judicial Code Section 240 (a) and upon the provisions of Revenue Act of 1926, Chapter 27, Section 1003, 44 Stat. 110;

(2) The original date of the judgment sought to be reversed is February 9th, 1945.

SPECIFICATION OF ERRORS.

(1) The decisions of the Courts below are in conflict with the decision of this Court in the case of *Dobson* v. *Commissioner*.

(2) The Courts below erred in holding that an erroneous claim by a taxpayer for an unallowable deduction in prior years is a bar to a renewal of the claim subsequently.

(3) The Courts below erred in holding that the bonds which were written down were wholly or partially worthless despite conclusive proof of solvency of obligors.

(4) The Courts below erred in holding, as a matter of law, that claims of the taxpayer for deductions in prior years had been "allowed" by the Commissioner upon uncontroverted evidence to the contrary.

(5) The Courts below erred in refusing to grant the petitioner relief under Section 116 of the Revenue Act of 1942.

POINT I.

THE DECISION OF THE CIRCUIT COURT OF APPEALS IS IN CONFLICT WITH THE DECISION OF THIS COURT IN DOBSON v. COMMISSIONER, 320 U. S. 489, 64 S. Ct. 239.

The Tax Court rendered its decision before the publication of the opinion of this Court in the *Dobson* case. Hence, it concluded its opinion (fol. 89) as follows:

> "The fact that petitioner enjoyed no tax benefit from such deductions in certain of the years when they were claimed and allowed is immaterial. Bank of Newberry, 1 T. C. 374. Cf. Virginian Hotel Corporation of Lynchburg v. Commissioner, 319 U. S. 523."

which represents a subordination of the opinions of the Tax Court as rendered in *Estate of James M. Collins* v. *Commissioner*, 46 B. T. A. 765 and 770 to the decision of the Circuit Court 133 F. 2d 732.

We pleaded in the Circuit Court herein, that the matter be remitted to the Tax Court for reconsideration in the light of the decision of this Court in the *Dobson* case. We do believe that had the opinion in the *Dobson* case been published

earlier, the Tax Court might have arrived at a different conclusion.

The *Virginian Hotel* case above cited refers to depreciation, which is a constant factor of loss which may not be accumulated by the taxpayer. A claim for worthlessness must be predicated upon some identifiable event,

> *Industrial Rayon Corp.* v. *Commissioner*, 94 Fed. (2d) 383 at 384.

The Treasury Department has so ruled and the Courts have sustained the Commissioner. Income Tax Unit Regulation, published as I. T. 1221, 11-CB 155, reads:

> "The amount of depreciation of bonds which banks are required to charge off by specific instructions of the State Bank Commissioner is deductible as a worthless portion of a debt only when the decline in value is due to the fact that the debtor corporation will not be able to pay the full amount of the obligation at maturity; but not where the decline is due to any other cause."

The opinions of the Circuit Court herein, we respectfully submit, stress some of the *obiter dicta* in the opinion of this Court in the *Dobson* case and overlook the basic principles involved in the opinion. The opinion of this Court at page 506 reads:

> "We only hold that no statute or regulation having the force of one and no principle of law compels the Tax Court to find taxable income in a transaction where as a matter of fact it found no economic gain and no use of the transaction to gain tax benefit."

Had the Tax Court given full consideration to all the facts and circumstances of the case and rendered its decision on the merits, the appeal from its decision may not have been taken. The petitioner feels aggrieved because of the Tax Court's ruling above quoted (fol. 89) that the fact that the petitioner enjoyed no tax benefit from such deductions in certain of the years when they were claimed is immaterial.

We respectfully submit that the fact is material and the failure to take such fact into consideration is not an adjudication on the merits. We respectfully submit that the facts and principles involved in the case at bar are analogous to the case of *Dobson* v. *Commissioner*, *supra*, with the exception that in the *Dobson* case the deductions claimed in prior years had concededly been "allowed" by the Commissioner, whilst in the case at bar we seriously question that such an allowance had been made.

POINT II.

THE TAXPAYER IS NOT ESTOPPED FROM ASSERTING LEGAL RIGHTS BY AN ERRONEOUS CLAIM FOR AN UNALLOWABLE DEDUCTION IN ITS RETURNS IN PRIOR YEARS.

The Tax Court found, as a matter of law (fols. 79-81), that the disclosure by the petitioner in its previous returns and by its claim for deductions thereunder for write-downs entered on its books by order of the bank examiners, constitutes a legal estoppel and bar to a consideration of the taxable gain on the sale of the bonds, on the merits.

We respectfully submit that such ruling is contrary to the established precedent and contrary to the statutes and contrary to the law and spirit of departmental regulations and practice.

The Revenue Act requires every corporation to make a disclosure to the Commissioner of Internal Revenue of pertinent facts to fix tax liability and to suggest therein its own assessment on printed forms furnished for that purpose. The statute does not provide for amendment of returns; that is left entirely to departmental regulations.

> *National Refining Co. of Ohio et al.*, 1 B. T. A. 236 at 240.

The Treasury Department regulations do permit amendments of return either by the Commissioner or by the taxpayer. The Commissioner as well as the taxpayer may file amended returns increasing or decreasing the tax liability reported in the original return. Where the Commissioner assesses additional taxes and does not file an amended return, the taxpayer need not do so.

Joseph Garneau, 1 B. T. A. 75;
Maryland Casualty Co. v. *U. S.*, 251 U. S. 342 at 354;
U. S. Internal Revenue Code, Sections 3612 (a and b) (app. p. 27).

We respectfully urge that the Court below attached too much importance to the affidavit of verification appended to the return and drew unwarranted inferences from such verification. The verification of a return by an officer of a corporation implies that the information on the return is correct to the best of his knowledge. This does not preclude any error made either in law or in fact as long as it is innocent and without intent to evade the tax. As a matter of fact, in the year 1938, when the returns under consideration were filed, the Treasury Department enforced the published official opinion of Hon. Morrison Shafforth, its chief counsel (G. C. M. 18525; app. p. 24), which permitted the restoration of write-downs to cost upon a sale of bonds in any case wherein the bank received no tax benefits from previous deductions for write-downs. The ruling was subsequently modified. So, too, in the year 1935 when the taxpayer filed its return, the Treasury Department had promulgated and enforced Article 23 K (1) of Regulation 86 and Article 191 of Regulation 77 as amended (app. p. 28), which provided that for income tax purposes the bank examiner's order was conclusive evidence of worthlessness and that the deduction must be claimed within the taxable year to entitle the bank to any credit. True, the decision of the Tax Court has declared that regulation unconstitutional but the taxpayer in filing his return should not be punished for observing Trea-

sury Department regulations or for following the official opinion of the general counsel of the Treasury Department or for adopting any other legal opinion when he does so in good faith. As was said by Chief Justice Hughes in the cases of

> *Panama Refining Co.* v. *Ryan*, 293 U. S. 388;
> *Morgan* v. *U. S.*, 304 U. S. 1 at page 22:
> "Administrative agencies must accredit themselves by acting in accordance with the cherished tradition embodying the basic concepts of fair play."

Assuming, but by no means conceding, that in the previous years of write-downs, the deductions were claimed by the taxpayer and that they were actually "allowed" by the Commissioner, nonetheless, under the provisions of Section 3801 (b) (2) of the Internal Revenue Code (app. p. 29), the error is not fatal and may be legally corrected. The opinion of the Tax Court (fol. 81) gives a finality to the original return filed by the taxpayer which is not in accord with the law and spirit of the law and with departmental regulations and practices. A tax return is not a pleading in an action but merely the opinion of the taxpayer as to his liability.

So, too, we respectfully urge that the Court below erred in holding that there was no law or regulation requiring the petitioner to claim the deduction for the write-downs, citing

> *Second National Bank of Philadelphia*, 33 B. T. A. 750-755.

The authority cited is not applicable to the situation here for the reason that the regulation of the Treasury Department 23K (1) of Regulation 86 (app. p. 29) in effect in 1935, differs from the language of Article 191 of Regulation 74 (app. p. 28) referred to in that opinion in the following important respects: It provides that charge-offs made by the banks, pursuant to the order of bank examiners, was *conclusively* presumed to be worthless to the extent of the

write-off, and further that the charge-off must be taken within the same taxable year. In 1935, when the petitioner filed its return, it had the alternative of either obeying the regulation or gambling that some court would eventually declare the existent regulation unconstitutional. The fact is, that the ruling was existent and was being enforced by the Department and was even invoked by counsel for the respondent at the hearing before the Tax Court (fol. 144).

The Court below also overlooked the fact that the definition of "taxable income" as given in all the revenue acts from 1918 to 1928 inclusive, is identical in language, as follows:

> "The net income shall be computable * * * in accordance with the methods of accounting regularly employed in keeping the books * * * of the taxpayer."

That definition was judicially approved

U. S. v. Anderson, et al., 269 U. S. 422 at 438.

Once the write-downs were entered in the books of the petitioner, under the direction of the bank examiners, the petitioner was legally obligated to disclose those entries to the Commissioner to determine tax liability. Good conscience and good bookkeeping made such procedure mandatory.

POINT III.

THERE IS NO RATIONAL BASIS IN THE EVIDENCE FOR THE FINDING OF THE TAX COURT THAT THE BONDS IN QUESTION WERE WORTHLESS AND ASCERTAINED TO BE WORTHLESS.

The Tax Court found as a fact (fol. 74) and subsequently repeated it as a conclusion of law (fol. 75):

> "The bonds written down in the respective years were then worthless to the extent of the write-downs and were then ascertained to be so worthless and charged off by petitioner."

We respectfully submit that there is no rational basis in the evidence or in the law to support that finding. "Worthlessness", as applied to bonds and other securities, has a very limited, definite and technical significance in tax jurisprudence. Decline in market price or shrinkage of value of underlying securities does not render a bond wholly or partially worthless for income tax purposes. The Treasury Department has so ruled and the courts have sustained the Commissioner. Thus, Income Tax Unit Regulation published as I. T. 1221, II-CB 155, reads:

> "The amount of depreciation of bonds which banks are required to charge off by specific instructions of the State Bank Commissioner is deductible as a worthless portion of a debt only when the decline in value is due to the fact that the debtor corporation will not be able to pay the full amount of the obligation at maturity; but not where the decline is due to any other cause."

The mere fact that the bank examiner wrote down the bonds of I. T. & T. from the cost of $39,000 to par, $30,000, was an admission by him that the bonds which were maturing in 1939 would be paid in full. It is a well known fact, of which the Court may well take judicial notice, that these bonds were in fact paid in full at maturity and that no one ever suggested or forecast any other possibility. It certainly cannot be said that the I. T. & T. bonds were worthless in whole or in part, either under the technical definition of worthlessness or even under the dictionary definition.

Similarly, the summary of the financial statements of the other obligors, as summarized in the findings of fact (fol. 65), indicating the net worth of each obligor running into the millions, gives rise to the same inference of solvency and ability to meet obligations. The same test and definition of worthlessness has been given by the Courts in:

> *Eaton, Petitioners* v. *Commissioner of Internal Revenue*, 143 Fed. (2d) 876;
> *Miami Beach & Bay Shore Co.* v. *Commissioner*, 136 Fed. (2d) 408;
> *Quinn et al Executors* v. *Commissioner*, 111 Fed. (2d) 372.

In the case at bar, the taxpayers sought and obtained all the available financial statements of the obligors, audited and certified by reputable certified public accountants, together with reports from the well known and reputable financial agencies such as Moody's, Poor's and Standard Services, which are commonly used by banks and other financial institutions and by traders in securities. These statements were submitted to counsel for the respondent and were checked by him before the trial for accuracy. Counsel for respondent (fol. 143) admitted that the documents had been checked and made no objection as to the form of the statements offered in evidence. He objected merely on the ground of their materiality.

We respectfully take exception to the statement in the opinion of the Tax Court (fol. 84) to the effect that there was no substantiating evidence to the correctness of these statements and that the proof is not persuasive that the bonds had a greater value than that determined by the bank examiner. Sales running into the millions are made almost daily in reliance upon the truth of the very statements marked in evidence upon which the financial world relies. The Tax Court, however, we believe and respectfully submit, misconceived the petitioner's purpose of introducing these financial statements in evidence. Assuming that each and all of these statements had been gross misrepresentations and falsehoods, it would not alter the legal principle involved, namely, that the petitioner (and presumably the bank examiner) having relied thereon and believed them to be true had a mental reaction of security which is not consistent with "ascertainment" of worthlessness. The courts have stressed that the "subjective attitude of the taxpayer is of more importance than the factual and objective evidence". The revenue laws were not intended to punish optimists.

Smith v. *Helvering*, 141 Fed. (2d) 529 at 531.

From the conceded facts of the case at bar, there was no "worthlessness" of the bonds and securities hence there could have been no ascertainment of worthlessness.

POINT IV.

THE TAX COURT ERRED IN FINDING THAT DEDUCTIONS CLAIMED IN PRIOR YEARS FOR BOND WRITE-DOWNS WERE "ALLOWED" BY THE COMMISSIONER.

The entire file of the petitioner's tax return for 1935 is in evidence (Exs. 2, 3, 4 and 5; fols. 544-594).

The revenue agent recommended assessment of tax liability (Ex. 2; fol. 545) of $1,803.17, based upon an amendment of the return in accordance with a detailed statement (fols. 556-561). At folio 557 the following appears:

> "(c) $63,613.59—This represents the write-down in market value of bonds held on December 31, 1935. Depreciation in value of securities is not allowable as a deduction from income; it should be charged to surplus. These bonds were not sold nor did they become worthless, their value was merely written down to market."

Accordingly, the net income for the taxable year was fixed at $13,113.97 by the revenue agent (fol. 561).

The foregoing schedule was further revised and amended (fol. 571) upon the following explanation:

> "$119,510.23—This represents bad debts written off by order of the Federal Bank authorities, but not charged to profit and loss. In accordance with G. C. M. 18525 C. B. XV-1 (1936) such debts shall be conclusively presumed to be worthless. It would appear that the taxpayer is compelled to take the deduction of the $119,510.23 in the year that it was ordered to be written off."

With the foregoing recommendation the file was forwarded to the Commissioner of Internal Revenue in Washington (fol. 570). The position taken by the petitioner herein and communicated to the Commissioner was:

That assuming that the foregoing rulings were correct, that, nonetheless, if the petitioner received credit under Section 121 of the Revenue Act (fols. 589-591) for exemption

on the preferred stock dividends paid to the Reconstruction Finance Corporation in the sum of $14,197.71, there would be absolutely no tax liability on the return as amended by the Collector. As a result, the question was purely academic and required no further protest from the petitioner (fol. 592).

That view was concurred in by the Collector and recommended for approval by the Commissioner (fol. 581) in the following language:

> "Momentarily ignoring the merits of the bad debt issue; the allowance of the $14,197.71 supra, would eliminate the taxable net income recommended by the examining officer."

That recommendation was accepted by the Commissioner and the case was closed (fol. 201).

All official action was based upon the assumption that the figure of net taxable income arrived at by the revenue agent, of $13,113.97 (fol. 561) after disallowance of the respective bond write-downs was *correct*. The assessment was eliminated only by reason of the exemption under Section 121 (fols. 589-591):

> "Any presumption that the petitioner's returns were correct disappears when the Commissioner after an examination officially and in the manner prescribed by statute determines that they were incorrect and so notifies the taxpayer."
>
> *Pennant Cafeteria Co.*, 5 B. T. A. 293.
>
> "When the Commissioner found that the deduction was not proper, the finding was prima facie correct, and cast upon the taxapayer the burden of disproving it by a preponderance of the evidence."
>
> *Quinn* v. *Commissioner*, 111 Fed. (2d) 373 or 373.

We respectfully submit that the file in evidence indicates that the claim for bond write-downs was specifically disallowed. In any event, a claim is not deemed "allowed" if no tax benefit accrues to the taxpayer, as a matter of law and as indicated in General Counsel's opinion G. C. M. 18525 (app. p. 24) sub. (j), subsequently revoked.

POINT V.

THE TAX COURT ERRED IN OVERRULING THE PETITIONER'S CLAIM UNDER SECTION 116 OF THE REVENUE ACT OF 1942 WITH RESPECT TO THE PROCEEDS OF THE SALE OF THE BONDS WRITTEN DOWN PRIOR TO 1938 OR 1939.

Section 116 of the Revenue Act of 1942 (app. p. 30) is retroactive and is incorporated into all prior revenue acts (sub. b and c).

This section and its enactment on the recommendation of the Treasury is referred to by the Supreme Court in the *Dobson* case (*supra*) at pages 248, 249 (64 S. Ct.). It is pointed out that the law is only declaratory of the pre-existing law laid down in prior court decisions opposed to distortion of taxpayers' incomes.

The crucial fact is that in the case at bar the petitioner concededly received no tax benefit from prior write-downs reported in its returns and was, therefore, entitled to relief under the provisions of this section.

CONCLUSION.

THE PETITION FOR WRIT OF CERTIORARI SHOULD BE GRANTED.

Respectfully submitted,

MEYER D. SIEGEL,
Attorney for Petitioner.

ROBERT SIEGEL,
Associate Counsel on Brief.

OPINION.

UNITED STATES CIRCUIT COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 97—October Term, 1944.

(Argued January 10, 1945 Decided February 9, 1945.)

THE NATIONAL BRONX BANK OF NEW YORK,
Petitioner,

—VS.—

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Before:

CHASE, HUTCHESON and FRANK,
Circuit Judges.

On Petition for Review of the Decision of The Tax Court of the United States. Affirmed.

MEYER D. SIEGEL and ROBERT SIEGEL, for Petitioner.

SAMUEL O. CLARK, JR., Assistant Attorney General, and SEWALL KEY, ROBERT N. ANDERSON, IRVING R. PANZER and MEYER ROTHWACKS, Special Assistants to the Attorney General, for Respondent.

HUTCHESON, *Circuit Judge*:

In the tax years in question, petitioner sold bonds for less than cost and in each year claimed the difference as a deductible loss. The commissioner disallowed the claim on the ground that the loss had occurred in earlier years and had been then claimed and allowed. This appeal is from a finding and order of the Tax Court sustaining the commissioner and denying the deductions accordingly. Here petitioner's arguments, presented with a vigor and earnestness almost, but not quite, sufficient to make the worse cause seem the better, take wide range. Petitioner is not content with merely challenging the sufficiency of the evidence to support the Tax Court's findings of fact. Invoking Sec. 116(a) 12, Revenue Act of 1942, "Recovery of Bad Debts, Prior Taxes and Delinquency Amounts", and the *Dobson* case[1] as binding precedent, it insists that this is a case for application of the "tax benefit" theory.

We cannot agree. The invoked statute does not deal with deductions for losses but with income attributable to recoveries. As was pointed out in *Dobson's* case at p. 505, it was enacted to deal with situations which, applying the rule of *Putnam National Bank* v. *Comm.* (5 Cir.) 50 Fed. (2) 158, *Helvering* v. *State Planters Bank* (4 Cir.), 130 F. (2) 44, *Commissioner* v. *U. S.* (3 Cir.) 130 F. (2) 894, resulted in apparent hardship. As to *Dobson's* case, there seems to be considerable confusion as to whether it is a precedent for anything, and, if so, for what.[2] It is quite clear though that, dealing as it did with recoveries in subsequent years in respect of stocks sold in prior years at a loss, and determining merely that the Tax Court was justified in finding as a fact that there was no taxable gain, the decision in *Dobson's* case is not a precedent for overturning the Tax Court's decision here of an entirely different question upon entirely different evidence. What is for decision here, and all that is for decision, is whether the Tax Court's finding,

1. 320 U. S. 489.
2. *Dobson* v. *Commissioner*: The Strange Ways of Law and Fact. (Paul), Vol. 57, No. 6, p. 753, Harvard Law Review. Cf. *Law and Fact in Insurance Cases* (Hutcheson), Vol. 23, No. 1, p. 1, Texas Law Review.

that the losses through partial worthlessness occurred and were claimed and allowed as deductions in earlier years, is in accordance with law. The simple statement of the undisputed facts convinces that it is.[3] The fact of which petitioner makes so much, that the examiner required the write-downs, cannot avail petitioner here, for the Tax Court did not base its finding of worthlessness on the fact alone of this requirement. It considered and gave due weight to the voluntary act of petitioner in claiming deductions as for established losses of the amounts of the write-downs as well as to all of the other evidence in the case, and the evidence taken as a whole supports the finding that in fact the partial losses to the extent claimed did then exist and were then actually ascertained, claimed and allowed. The decision and order appealed from is Affirmed.

CHASE, *Circuit Judge* (concurring):

The decisive issue is whether the petitioner's basis for determining gain or loss on the sale of the bonds should be the cost of them or that cost less the amount of the deduction allowed the petitioner in a previous year to the extent that it then wrote down the bonds. The petitioner insists that the deduction thus allowed should not affect its basis because it so happened that the deduction has never affected its tax, as it received no benefit from the allowance of the deduction since no income was thereby freed from taxation in the year of the allowance. It also insists that the write-down is of little, or no, evidential significance as to the then value of the bonds because it was involuntary and required by the bank examiner.

---

3. These are that in years prior to the tax years, write-downs were made on the order of the National Bank examiner; that petitioner in income tax returns for years prior to the tax year in question, of its own volition, claimed the amounts of the write-downs as deductions; that these claims were allowed; that the bonds were sold at a figure substantially in accordance with the claimed losses and there was no proof fixing these losses as having occurred in the year of sale or in any years other than the ones in which they were written off.

As the taxability of recoveries in later years of the amount in whole or in part of tax deductions previously claimed and allowed is not involved, that part of *Dobson* v. *Commissioner*, 320 U. S. 489, which deals with the effect of the failure to secure any tax benefit from the allowance of the deduction on the question of the actual receipt of income when making such recoveries is not here applicable.

The fact that the bank examiner did require the write-down, coupled with the fact that the bank made it, is some evidence that the bond had then become worthless to the extent of the write-down and the weight and effect of the evidence as to the circumstances under which the write-down was made were for the Tax Court to determine. When that evidence is considered in connection with the fact that the bank, under no compulsion from the bank examiner to claim any deduction in its income return for that year, did claim such deduction and the Commissioner allowed it there was substantial evidence that the bonds had become worthless to that extent in the year the deduction was claimed and allowed. Accordingly there was the required evidential support of the finding of the Tax Court to the effect that the petitioner did not suffer any actual loss in the later taxable years in which it sold the bonds. That being so, *Dobson* v. *Commissioner*, *supra*, supports not the petitioner but the respondent and requires an affirmance.

Frank, Circuit Judge, concurs in Judge Chase's opinion.

APPENDIX.

Treasury Department Bulletin

General Counsel's Memorandum 18525

An opinion is requested with respect to the application of Treasury Decision 4633 (C. B. XV-1, 118 (1936), amending the last paragraph of article 191, Regulations 77, applicable to the Revenue Act of 1932, and the last paragraph of article 23(k)-1, Regulations 86, applicable to the Revenue Act of 1934, to read as follows:

> Where banks or other corporations which are subject to supervision by Federal authorities (or by State authorities maintaining substantially equivalent standards) in obedience to the specific orders of such supervisory officers charge off debts in whole or in part, such debts shall be conclusively presumed, for income tax purposes, to be worthless or recoverable only in part, as the case may be, but in order that any amount of the charge-off may be allowed as a deduction for any taxable year it must be shown that the charge-off took place within such taxable year.

The same provision is incorporated in article 23(k)-1, Regulations 94, relating to the Revenue Act of 1936. The pertinent statutory provisions are section 23(j) of the Revenue Act of 1932, section 23(k) of the Revenue Act of 1934, and section 23(k) of the Revenue Act of 1936, which provide for the allowance of——

> * * * *Bad debts.*—Debts ascertained to be worthless and charged off within the taxable year * * *; and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction.

It is to be noted that the language of the statute relating to *partially* worthless debts does not *require* the taxpayer to claim such partial worthlessness as a deduction in any

particular year. It is simply provided that the Commissioner *may* allow as a deduction such partial worthlessness in an amount not in excess of the part *charged off within the taxable year*. Treasury Decision 4633 must, of course, be applied in the light of such controlling statutory provision. Moreover, that decision must be construed in connection with the general regulations governing bad debts. (Article 191 *et seq.* of Regulations 77 and article 23(k)-1 *et seq.* of Regulations 86 and 94.)

Treasury Decision 4633 and related regulations under the Revenue Acts of 1932, 1934, and 1936 establish the following principles applicable in bank cases for the years governed by those Acts:

(*a*) The order of the bank examiner relating to the charge-off in whole or in part of a debt owed to the bank is material only as *establishing conclusively* either total or partial worthlessness of such debt.

(*b*) Where *total worthlessness* of a debt has been so ascertained in any taxable year and the debt charged off the books of the bank in the same year, deduction on account of such ascertainment and charge-off is allowable only for the taxable year in which such ascertainment and charge-off are made. In other words, deduction for total worthlessness so ascertained may be taken only in the taxable year in which occur both ascertainment of total worthlessness and the necessary charge-off.

(*c*) Where *partial* worthlessness of a debt has been so ascertained, such partial worthlessness may be allowed as a deduction in the year of such ascertainment, provided such partial worthlessness is charged off during such year.

(*d*) Where *partial worthlessness* of a debt has been so ascertained but no charge-off made in the year of such ascertainment, no deduction is allowable in the income tax return of the bank for the year of such ascertainment.

(*e*) Where *partial worthlessness* of a debt has been so ascertained in a certain amount in one taxable year *but no charge-off made or deduction allowed therefor in that taxable year*, and during a subsequent taxable year the amount of such partial worthlessness is ascertained in accordance with Treasury Decision 4633 in a greater amount than the amount of such partial worthlessness ascertained during the preceding taxable year, such partial worthlessness may be allowed by the Commissioner in such subsequent taxable year in the greater amount *ascertained and charged off in such later taxable year.*

(*f*) Where such *partial worthlessness* has been so ascertained in a particular taxable year but not charged off or allowed as a deduction for income tax purposes for that year, and *total worthlessness* is ascertained in accordance with Treasury Decision 4633 in a later taxable year and the necessary charge-off of such total worthlessness is made in the later taxable year, deduction for such total worthlessness is allowable for that year.

(*g*) If a debt has been so ascertained to be worthless either in whole or in part in any particular taxable year but has not been allowed as a deduction for income tax purposes in whole or in part as the case may be, amounts subsequently collected on account of such debt are not required to be included in gross income for the taxable year of such receipt (article 191, Regulations 77; article 23(k)-1, Regulations 86 and 94).

(*h*) If a debt has been so ascertained to be partially worthless in a particular taxable year but such partial worthlessness has not been allowed as a deduction for income tax purposes in such taxable year, and the debt is subsequently sold, no adjustment of the basis of the debt should be made in determining gain or loss from such sale. This rule is equally applicable to cases where there has been ascertainment of partial worthlessness but no charge-off

thereof, and to cases where there have been both ascertainment of partial worthlessness and a charge-off, provided no amount has been allowed as a deduction for income tax purposes in either situation.

(*i*) If a debt was so ascertained to be *totally worthless* in 1932 or subsequent years, which are governed by Treasury Decision 4633 or article 23(k)-1, Regulations 94, but no amount has been allowed as a deduction for income tax purposes for the year of such ascertainment, and subsequently the debt is sold, the bank may not deduct any loss based upon the difference between the original basis of such debt and the sale price. It is the opinion of this office that to allow a loss based upon sale under such circumstances in a year subsequent to the year of ascertainment of total worthlessness would permit by indirection the evasion of the statutory provisions requiring deductions based upon claims of total worthlessness of a debt to be taken only in the year of ascertainment of such total worthlessness and charge-off. This rule is equally applicable to cases where the statute of limitations on refunds for the year of ascertainment of worthlessness has run and to cases where such statutory period has not expired. If, however, in any such case the debt is subsequently sold for an amount in excess of the original basis of such debt, it is held that the bank is not taxable on an amount greater than the excess of the proceeds of the sale over such original basis. A tax based upon the entire proceeds of the sale in such case would be of doubtful validity inasmuch as it would be based in substantial part upon an item which is not in reality gain or income. See *Goodrich* v. *Edwards*, 255 U. S., 527; *Koshland* v. *Helvering*, 298 U. S., 441.)

(*j*) Where, in cases governed by the Revenue Acts of 1932 and 1934, a bad debt deduction based upon alleged total worthlessness was disallowed to a bank prior to the promulgation of Treasury Decision 4633 under circum-

stances which would have entitled the bank to such a deduction under the provisions of Treasury Decision 4633, and the statute has now barred a refund for the earlier taxable period, it is the opinion of this office that upon subsequent sale of such debt by the bank no adjustment should be made in the original basis of the debt for the purpose of determining gain or loss from the sale.

It is believed that some of the difficulty in bank cases has arisen from failure to recognize that Treasury Decision 4633 can only operate as a construction or application of a controlling statute, and that it must be read in the light of the statutory provisions which it seeks to interpret in the application of the statute to these specific cases (bank cases). It can not, of course, be taken as setting out substantive rules of law contrary to the plain provisions of the statute. Read in this light, Treasury Decision 4633 can only be taken as setting up a practical rule for *ascertainment* of total or partial worthlessness of debts in bank cases, and not as undertaking to give any effect to such ascertainment which will contravene provisions of the statute or related regulations.

The deductions for bad debts contemplated by the clause "allowed as a deduction for income tax purposes" (as used in (*f*), (*g*), (*h*), and (*i*) above) refer to deductions for bad debts which accomplished a reduction in tax liability and do not refer to deductions for bad debts in cases in which the taxpayer, on account of other allowable deductions, had no net income irrespective of the deduction for bad debts. [Signed by Morrison Shafroth, Chief Counsel, Bureau of Internal Revenue.]

Article 191, Regulations 77

Where banks or other corporations which are subject to supervision by Federal authorities (or by State authorities maintaining substantially equivalent standards) in obedience to the specific orders, or in accordance with the general policy of such supervisory officers, charge off debts

in whole or in part, such debts shall, in the absence of affirmative evidence clearly establishing the contrary, be presumed, for income tax purposes, to be worthless or recoverable only in part, as the case may be.

Article 23 k(1) of Regulation 86 Amending

Article 191 of Regulation 77

> "Where banks or other corporations which are subject to supervision by Federal authorities (or by State authorities maintaining substantially equivalent standards) in obedience to the specific orders of such supervisory officers charge off debts in whole or in part, such debts shall be *conclusively* presumed, for income tax purposes, to be worthless or recoverable only in part, as the case may be, but in order that any amount of the charge-off may be allowed as a deduction for any taxable year it must be shown that the charge-off took place within such taxable year." (Italics ours.)

U. S. Internal Revenue Code—Section 3801 (b)

(b) Circumstances of adjustment.—When a determination under the income tax laws——

> (2) Allows a deduction or credit which was erroneously allowed to the taxpayer for another taxable year or to a related taxyear:

and on the date the determination becomes final, correction of the effect of the error is prevented by the operation (whether before or after May 28, 1938) of any provision of the internal revenue laws other than this section and other than Section 3761 (relating to compromises), then the effect of the error shall be corrected by an adjustment made under this section. Such adjustment shall be made only if there is adopted in the determination a position maintained by the Commissioner (in case the amount of the adjustment would be refunded or credited in the same manner as an overpayment under subsection (c) or by the taxpayer with respect to whom the determination is made (in case the

amount of the adjustment would be assessed and collected in the same manner as a deficiency under subsection (c)), which position is inconsistent with the erroneous inclusion, exclusion, omission, allowance, disallowance, recognition or nonrecognition, as the case may be.

U. S. Internal Revenue Code—Section 3612

(a) Authority of Collector.—If any person fails to make and file a return or list at the time prescribed by law or by regulation made under authority of law, or makes, wilfully or otherwise, a false or fraudulent return or list, the collector or deputy collector shall make the return or list from his own knowledge and from such information as he can obtain through testimony or otherwise.

(b) Authority of Commissioner.—In any such case the Commissioner may, from his own knowledge and from such information as he can obtain through testimony or otherwise——

1. To Make Return.—Make a return, or

2. To Amend Collector's Return.—Amend any return made by a collector or deputy collector.

Section 116. Recovery of bad debts, prior taxes and delinquency amounts.

(a) Exclusion From Income.—Section 22(b) (relating to exclusions from gross income) is amended by adding at the end thereof the following new paragraph:

> "(12) Recovery of bad debts, prior taxes, and delinquency amounts.—Income attributable to the recovery during the taxable year of a bad debt, prior tax, or delinquency amount, to the extent of the amount of the recovery exclusion with respect to such debt, tax, or amount. For the purposes of this paragraph:

"(A) Definition of Bad Debt.—The term 'bad debt' means a debt on account of worthlessness or partial worthlessness of which a deduction was allowed for a prior taxable year.

"(B) Definition of Prior Tax.—The term 'prior tax' means a tax on account of which a deduction or credit was allowed for a prior taxable year.

"(C) Definition of Delinquency Amount.—The term 'delinquency amount' means an amount paid or accrued on account of which a deduction to or credit was allowed for a prior taxable year and which is attributable to failure to file return with respect to a tax, or pay a tax, within the time required by the law under which the tax is imposed, or to failure to file return with respect to a tax or pay a tax.

"(D) Definition of Recovery Exclusion.—The term 'recovery exclusion', with respect to a bad debt, prior tax, or delinquency amount, means the amount, determined in accordance with regulations prescribed by the Commissioner with the approval of the Secretary, of the deductions or credits allowed, on account of such bad debt, prior tax, or delinquency amount, which did not result in a reduction of the taxpayer's tax under this chapter (not including the tax under Section 102 or corresponding provisions of prior revenue laws, reduced by the amount excludible in previous taxable years with respect to such debt, tax, or amount under this paragraph.

"(E) Special Rules in Case of Section 102 Tax and Personal Holding Company Tax.—In the application of subparagraphs (A), (B), (C), and (D) in determining the tax under section 102 or Subchapter A of Chapter 2, a recovery exclusion allowed for the purposes of Chapter 1 shall be allowed for the purpose of such section or subchapter whether or not the bad debt, prior tax, or delinquency amount resulted in a reduction of the section 102 tax or Subchapter A tax for the prior taxable year; and in the case of a bad debt, prior tax, or

delinquency amount not allowable as a deduction or credit for the prior taxable year under Chapter 1 (except section 102) but allowable for the same taxable year under such section or subchapter a recovery exclusion shall be allowable for the purposes of such section or subchapter if such bad debt, prior tax, or delinquency amount did not result in a reduction of the tax under such section 102 or such Subchapter A. As used in this subparagraph references to Chapter 1, section 102, and Subchapter A in the case of taxable years not subject to the Internal Revenue Code, shall be held to be made to corresponding provisions of prior revenue Acts."

(b) EFFECTIVE DATE OF AMENDMENTS UNDER THE INTERNAL REVENUE CODE.—The amendments made by this section shall be applicable with respect to taxable years beginning after December 31, 1938.

(c) UNDER PRIOR REVENUE ACTS.—For the purposes of the Revenue Act of 1938 or any prior revenue Act, the amendments made to the Internal Revenue Code by subsection (a) of this section shall be effective as if they were a part of each such revenue Act on the date of its enactment.

[redacted]

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In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 1233

THE NATIONAL BRONX BANK OF NEW YORK,
PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and memorandum opinion of the Tax Court (R. 19–30) are unreported; the opinion of the Circuit Court of Appeals (R. 203–205) is reported at 147 F. 2d 651.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on February 27, 1945 (R. 206). The petition for a writ of certiorari was filed on May 3, 1945. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the Tax Court erred in holding that bond write-downs, made at the order of a national bank examiner and taken by the petitioner as bad debt deductions without challenge by the Commissioner, should not be restored to the cost basis of the bonds for the purpose of computing gain or loss on their sale in the taxable years irrespective of whether the deductions in the prior years were of any tax advantage to petitioner.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations are set forth in the Appendix, *infra*, pp. 7–9.

STATEMENT

The facts as found by the Tax Court (R. 20–25) may be summarized as follows:

The petitioner, a national banking association, was incorporated in 1926 (R. 20). Its income tax returns for the taxable years involved were made on the accrual basis and were filed with the Collector of Internal Revenue for the Fourteenth District of New York (R. 20).

In the years 1932, 1933, 1935 and 1936, a national bank examiner ordered the petitioner to write down on its books the value of certain bonds held by it (R. 20). The securities, the date acquired by the petitioner, the par value of the bonds, the amount and years of write-downs, the write-down value in the years the bonds were eventually sold, the selling price, and the loss or gain based upon the write-down

value and based upon cost, are all set forth in the opinion of the Tax Court (R. 21). The petitioner claimed the amounts of the write-downs as deductions for bad debts on its returns for the years 1932, 1933, 1935 and 1936, and the returns were accepted by the Commissioner as filed (R. 22). The bonds written down were worthless to the extent of the write-downs, and were then ascertained to be worthless by the petitioner (R. 25). The petitioner realized a tax benefit of $3,334.93 in 1936 from the write-down deductions; no tax benefits resulted from the deductions in the other years (R. 22–23). In 1938 and 1939, the petitioner sold the bonds involved, and in its returns for those years claimed loss deductions, using the original cost of the bonds to it as a basis (R. 25). The Commissioner disallowed the deductions on the ground that the basis to be used was the cost less the amounts written down and deducted in the petitioner's returns for prior years.

The Tax Court held that the cost basis of the bonds sold in 1938 and 1939 should be reduced in the amount of the write-down deductions previously claimed and allowed, and sustained the Commissioner's determination that a deficiency existed (R. 30). The Circuit Court of Appeals affirmed (R. 206).

ARGUMENT

The Tax Court found as facts (R. 29–30) that the bonds written down in the years 1932, 1933, 1935 and 1936, were then worthless to the extent of the amount of the write-downs, were then ascertained to be so worthless, and were then duly charged off by

the petitioner bank. That there was substantial evidence in the record to support these findings seems clear. The write-downs were in fact made; they were claimed as deductions by the petitioner in its tax returns for the years of their making; and the bonds were sold at a figure substantially in accord with the losses claimed.[1] No evidence was adduced to fix the time of the losses in some period other than the ones in which the write-downs were made. Section 113 (b) (1) (A) of the applicable acts (Appendix, *infra*, p. 8) consequently required the adjustment made by the Commissioner in respect of the basis of the bonds.

It is true that the impetus for the write-downs came in the first instance from the bank examiner's order, but, needless to say, the examiner had nothing to do with petitioner's taking the bad debt deductions in its tax returns. It did this entirely of its own volition. As the bad debt provisions of the applicable acts make clear (Appendix, *infra*, p. 7), petitioner had the option of claiming or not claiming partial worthlessness quite as it saw fit.

[1] All of the bonds involved, except for one group of International Tel. and Tel. bonds, were written down to a value lower than par (R. 21). The fact that these International Tel. and Tel. bonds were only written down to par does not deprive the Tax Court's finding that they were partially worthless of evidentiary support, because, even assuming that par value and not cost is the basis upon which partial worthlessness should be calculated, for all that appears in the record International Tel. and Tel. may not have been petitioner's primary debtor. These bonds may have been acquired from a third person as collateral on a debt larger than the par value of the bonds.

There was no question of its making a claim in the years of the write-downs or forever holding its peace. *Eljer Co.* v. *Commissioner*, 134 F. 2d 251 (C. C. A. 3d), and cases cited therein. See also *Bingham* v. *Commissioner*, 105 F. 2d 971 (C. C. A. 2d). Hence it seems to us manifest that there is no merit to petitioner's plea that its action in writing down the bonds in the earlier years cannot be regarded as an ascertainment of worthlessness because involuntary. Plainly it "ratified" the examiner's appraisal when it took the deductions. There was further "ratification" of the *fact* of then partial worthlessness when the bonds were sold at approximately the write-down figures.

There is no more merit, in our view, to petitioner's contention that some of the former deductions, claimed by the petitioner and accepted by the Commissioner (R. 22), must themselves now be disregarded because they resulted in no tax benefit when taken. Neither the language in *Dobson* v. *Commissioner*, 320 U. S. 489, 505, rehearing denied, 321 U. S. 231, with respect to what might be termed the tax benefit theory, nor Section 116 (a) (12) of the Revenue Act of 1942 has any application here. For this Court, in the *Dobson* case, was speaking of the tax treatment of recoveries of amounts previously written off and deducted in years when deductions brought no tax advantage; that is also the subject of the statute to which we have just made reference. But the subject matter of the controversy at bar is

not recoveries and is not related to recoveries; we are here concerned not with whether an item should be taxed as income, but with whether the cost basis of an item shall be reduced by the amount of a once-allowed deduction. The Tax Court properly held that a taxpayer may not restore to its cost basis the amounts previously—and properly—allowed as deductions. Cf. *Virginian Hotel Corp.* v. *Helvering*, 319 U. S. 523.

CONCLUSION

There is no warrant for further review. The Tax Court's decision was entitled to affirmance, for its findings of fact were based on substantial evidence and, beyond that, the only other issue is one of proper tax accounting. *Dobson* v. *Commissioner*, *supra*. For these reasons, and because there is no conflict, the petition should be denied.

Respectfully submitted.

HUGH B. COX,
Acting Solicitor General.

SAMUEL O. CLARK, JR.,
Assistant Attorney General.

SEWALL KEY,
J. LOUIS MONARCH,
MARYHELEN WIGLE,
Special Assistants to the Attorney General.

MAY 1945.

APPENDIX

Revenue Act of 1932, c. 209, 47 Stat. 169:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME. In computing net income there shall be allowed as deductions:
>
> * * * * *
>
> (j) *Bad Debts.*—Debts ascertained to be worthless and charged off within the taxable year (or, in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction.
>
> * * * * *

Section 23(k) of the Revenue Act of 1934, c. 277, 48 Stat. 680, and Section 23(k) of the Revenue Act of 1936, c. 690, 49 Stat. 1648, are identical with Section 23(j) of the Revenue Act of 1932, above.

Revenue Act of 1938, c. 289, 52 Stat. 447:

> SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.
>
> * * * * *
>
> (b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) *General Rule.*—Proper adjustment in respect of the property shall in all cases be made—

(A) for expenditures, receipts, losses, or other items, properly chargeable to capital account, including taxes and other carrying charges on unimproved and unproductive real property, but no such adjustment shall be made for taxes or other carrying charges for which deductions have been taken by the taxpayer in determining net income for the taxable year or prior taxable years;

* * * * *

Section 113(b) (1) (A) of the Internal Revenue Code (26 U. S. C. 113), is identical with Section 113(b) (1) (A) of the Revenue Act of 1938, above.

Treasury Regulations 77, promulgated under the Revenue Act of 1932:

ART. 191. *Bad debts.*— * * *

* * * * *

Where banks or other corporations which are subject to supervision by Federal authorities (or by State authorities maintaining substantially equivalent standards) in obedience to the specific orders, or in accordance with the general policy of such supervisory officers, charge off debts in whole or in part, such debts shall, in the absence of affirmative evidence clearly establishing the contrary, be presumed, for income tax purposes, to be worthless or recoverable only in part, as the case may be.

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 23 (k)–1. *Bad debts.*—* * *

* * * * *

Federal or State authorities incident to the regulation of banks and certain other corporations may require that debts be charged off in whole or in part. If, in any such case, the basis of the requirement is the worthlessness or partial recoverability of the debt, as the case may be, such charging off will, for income tax purposes, be considered prima facie evidence of worthlessness; but if the charging off is due to market fluctuations, or if no reasonable attempt has been made to determine to what extent recovery may be made, no deduction for income tax purposes of the amount so charged off can be allowed.

Treasury Regulations 101, promulgated under the Revenue Act of 1938:

ART. 23 (k)–1. *Bad debts.*—* * *

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(c) Where banks or other corporations which are subject to supervision by Federal authorities (or by State authorities maintaining substantially equivalent standards) in obedience to the specific orders of such supervisory officers charge off debts in whole or in part, such debts shall be conclusively presumed, for income tax purposes, to be worthless or recoverable only in part, as the case may be, but in order that any amount of the charge-off may be allowed as a deduction for any taxable year it must be shown that the charge-off took place within such taxable year.

Section 19.23 (k)–1 of Treasury Regulations 103, promulgated under the Internal Revenue Code, is identical with Article 23 (k)–1 of Treasury Regulations 101, above.

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